



**CONFIDENTIAL ATTORNEY-CLIENT PRIVILEGE  
MEMORANDUM**

TO: Coalition to Stop Internet Gambling  
FROM: Warner Norcross & Judd LLP  
DATE: May 31, 2016  
  
RE: Analysis of Senate Bills 889 and 890

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**INTRODUCTION AND SUMMARY OF CONCLUSIONS**

On April 14, 2016, Michigan Senator Mike Kowall introduced SB 889, the Lawful Internet Gaming Act. The bill's purpose is to expand gambling in Michigan by legalizing and regulating online casino games and other forms of Internet gambling in the State of Michigan. This bill was introduced alongside SB 890, which would amend the gambling section of the Michigan penal code to create an exemption for Internet gambling authorized under SB 889. Absent this authorizing legislation, online gambling in Michigan is illegal under the federal Unlawful Internet Gambling Enforcement Act of 2006.

You have asked us to review SB 889 and SB 890 as introduced and assess their constitutionality. The bills—particularly SB 889—violate numerous provisions of the Michigan and United States Constitutions, including the following:

- Article 4, § 41 of the Michigan Constitution
- The Dormant Commerce Clause
- Equal protection/substantive due-process requirements
- Procedural due-process requirements
- Imposition of unreasonable licensing and application fees
- Separation of powers
- The void for vagueness doctrine
- And the overbreadth doctrine

The most critical of these violations is Article 4, § 41, which provides that no new Michigan law authorizing gaming is effective without the approval of a majority of voters in both a statewide election *and* the city or township where gambling will take place. Because Internet gambling is likely to take place everywhere, there is a strong argument that a majority vote within every single Michigan city and township is necessary to make SB 889 and SB 890 effective.

In addition, although not *per se* constitutional violations, the bills raise a number of practical problems, including exempting from FOIA disclosure information obtained pursuant to the Lawful Internet Gaming Act, and requiring tribes to waive their sovereign immunity to participate in Internet gaming.

## BACKGROUND

### Legal Gambling in Michigan

Michigan first opened the door to gambling as the State tried to deal with the financial ramifications of the Great Depression. On June 28, 1933, Governor William A. Comstock signed the Racing Act of 1933 to authorize and regulate pari-mutuel horse racing in Michigan. Pari-mutuel betting remained the only state-sanctioned gambling authorized anywhere in the country for the next 30 years, until New Hampshire became the first state to authorize a state lottery in 1963. Several states followed New Hampshire's lead, and in 1972—again under pressure to balance the state budget—Michigan amended its constitution through a ballot referendum to “authorize lotteries and permit the sale of lottery tickets in the manner provided by law.” Const 1963, art 4, § 41. Later that year, the Michigan Legislature created the first state lottery, see MCL 432.1 *et seq.* and authorized charitable gambling a short time later, see MCL 432.101 *et seq.*

The first tribal casino opened in Michigan in 1984, and four years later, Congress enacted IGRA, the Indian Gaming Regulatory Act, which authorized tribes to open casinos after successfully negotiating a gaming compact with the state. See 25 USC 2701 *et seq.* A proliferation of new tribal casinos followed, some of which continue to pay the Michigan Strategic Fund and the Michigan Economic Development Corporation pursuant to the revenue-sharing formula in their state compacts, and some of which do not. See Michigan Gaming Control Board, Payments to MSF or MEDC as of 3/3/2016 <[http://www.michigan.gov/documents/8\\_percent\\_Payments\\_76616\\_7.pdf](http://www.michigan.gov/documents/8_percent_Payments_76616_7.pdf)> (accessed May 31, 2016).

In 1996, Michigan voters passed another statewide referendum that expanded legalized gambling in the State by authorizing limited casino gambling in Detroit. Proposal E. Initiated Law 1 of 1996 (codified at MCL 432.201-432.226). The Legislature responded by creating the Michigan Gaming Control Board. MCL 432.204. The Board has no authority over tribal casinos but does regulate the three casinos that currently operate in the City of Detroit.

### Proposal 1

By the early 2000s, horse-racing tracks sought legislative approval to expand on-site gambling to include slot machines, off-track racing theaters, and account wagering. The tracks persuaded the Michigan Senate and House of Representatives to pass bills to that effect in 2004. But before the bills were enacted, another referendum initiative involving gambling appeared on the 2004 general-election ballot as Proposal 1. The official ballot language appeared as follows:

#### PROPOSAL 04-1

A PROPOSAL TO AMEND THE STATE CONSTITUTION TO  
REQUIRE VOTER APPROVAL OF ANY FORM OF  
GAMBLING AUTHORIZED BY LAW AND CERTAIN NEW  
STATE LOTTERY GAMES

The proposed constitutional amendment would:

- Require voter approval of any form of gambling authorized by law after January 1, 2004.
- Require voter approval of any new state lottery games utilizing "table games" or "player operated mechanical or electronic devices" introduced after January 1, 2004.
- Provide that when voter approval is required, both statewide voter approval and voter approval in the city or township where gambling will take place must be obtained.
- Specify that the voter approval requirement does not apply to Indian tribal gaming or gambling in up to three casinos located in the City of Detroit.

Should this proposal be adopted?

Yes

No

Michigan voters approved the proposal, thus amending article 4, § 41 of the state constitution to add the following italicized language:

The legislature may authorize lotteries and permit the sale of lottery tickets in the manner provided by law. *No law enacted after January 1, 2004, that authorizes any form of gambling shall be effective, nor after January 1, 2004, shall any new state lottery games utilizing table games or player operated mechanical or electronic devices be established, without the approval of a majority of electors voting in a statewide general election and a majority of electors voting in the township or city where gambling will take place. This section shall not apply to gambling in up to three casinos in the City of Detroit or to Indian tribal gaming.* [Const 1963, art 4, § 41 (Proposal 1).]

In 2006, the Michigan Attorney General opined that Proposal 1 does not apply to games that the Commissioner of the Bureau of State Lottery may authorize pursuant to the Traxler-McCauley-Law-Bowman Bingo Act (MCL 432.101 *et seq.*), which authorizes charitable organizations to conduct games of chance under specified conditions (such as bingo, raffles, millionaire parties, and the like). OAG, 2006, No. 7190, 2006 WL 690823.

Two years later, in May 2008, several horse-racing tracks filed a federal lawsuit seeking a declaration that Proposal 1 violated the federal Constitution. The United States Court of Appeals for the Sixth Circuit rejected those claims in 2010 and upheld the constitutionality of Proposal 1. *Northville Downs v Granholm*, 622 F3d 579 (CA 6, 2010).

## **Proposed "Lawful Internet Gaming Act"**

Senate Bill 889 would allow Internet wagering carried out in accordance with the proposed Lawful Internet Gaming Act. Among other things, the Bill creates a Division of Internet Gaming within the existing Michigan Gaming Control Board, and allows the Division to issue up to eight Internet gaming licenses if applicants meet certain criteria, pay a \$100,000 application fee, and pay a \$5 million license fee in the form of an advance payment of the applicant's Internet wagering taxes. Those taxes would be assessed as a 10% cut of gross gaming revenue received by an Internet gaming licensee from Internet gaming authorized under the Act.

Senate Bill 890 would amend the Michigan Penal Code to exclude activities authorized by the Lawful Internet Gaming Act from Chapter XLIV of the Code, which prescribes certain penalties for illegal gambling activities taking place with the State of Michigan.

Each bill would purportedly take effect 90 days after enactment. The bills are tie-barred.

## **CONSTITUTIONAL ANALYSIS**

### **I. Article 4, § 41**

As noted above, the people of Michigan amended the Constitution through the referendum process by enacting Proposal 1 in 2004. The Proposal added the following words to the existing Article 4, § 41 of Michigan's Constitution:

No law enacted after January 1, 2004, that authorizes any form of gambling shall be effective, nor after January 1, 2004, shall any new state lottery games utilizing table games or player operated mechanical or electronic devices be established, without the approval of a majority of electors voting in a statewide general election and a majority of electors voting in the township or city where gambling will take place. This section shall not apply to gambling in up to three casinos in the City of Detroit or to Indian tribal gaming. [Const 1963, art 4, § 41 (Proposal 1).]

The Lawful Internet Gaming Act falls easily within the scope of Proposal 1, satisfying both of Proposal 1's prerequisites.

First, if passed and signed into law, the Lawful Internet Gaming Act would be a "law enacted after January 1, 2004." Second, the Act would unequivocally authorize a "form of gambling," specifically, Internet gambling. Accordingly, the Act triggers Proposal 1's proscription: the Lawful Internet Gaming Act will not be effective "without the approval of a majority of electors voting in a statewide general election and a majority of electors voting in the township or city where gambling will take place." As a result, that portion of the Act that states the Act will "take[ ] effect 90 days after the date it is enacted into law" violates art 4, § 41 of Michigan's Constitution and is invalid.

To become effective, the Act would, at a minimum, require an affirmative vote of approval by "a majority of electors voting in a statewide general election." But there is a strong argument that the Act would also require approval of "a majority of electors voting" in every Michigan "township or city where gambling will take place."

When Michigan voters approved Proposal 1, they presumably contemplated a general prohibition on traditional brick-and-mortar casinos. So if a new casino was proposed for the City of Lansing, that casino would require approval by a majority of voters both in a statewide election *and* in a City of Lansing election. But Proposal 1's plain language is not limited to brick-and-mortar casinos and applies equally on its face to the creation of an Internet casino. For example, if it is anticipated that an Internet casino's customers will participate in Internet gaming from their homes in Detroit, Lansing, and Grand Rapids, then "gambling will take place" in Detroit, Lansing, and Grand Rapids. Accordingly, Proposal 1 requires an affirmative vote by a majority of electors voting in each one of those cities *in addition to* an affirmative statewide vote. If the voters in Detroit and Lansing approve of the proposal and voters in Grand Rapids turn it down, then the Act would not be effective in Grand Rapids. In other words, any casino that receives a license for Internet gaming would have to calibrate its software in such a way so as to prohibit anyone from engaging in Internet gaming from a Grand Rapids location (or any other location where local voters declined to authorize Internet gaming) or risk being charged with conducting illegal gaming in Grand Rapids.

There is nothing in Proposal 1's text that contemplates a bypass around the requirement that local voters approve a proposed expansion of gambling within the State when gambling will take place in a particular locality. The only way to avoid the local-voting requirement would be a new constitutional amendment that modifies § 41's plain language. Indeed, the unlikelihood of obtaining an affirmative vote for Internet gaming by every local township and city within the State, combined with the practical difficulty of operating an Internet casino with multiple jurisdictional "holes" within the State's borders, might render SB 889 and SB 890 ineffective absent such a constitutional amendment.

Proponents of SB 889 and SB 890 have suggested that Proposal 1 may be inapplicable here to the extent that it is a Detroit casino or tribal casino that seeks a license for internet gaming. This suggestion is based on the last sentence of article 4, § 41, which reads: "This section does not apply to gambling in up to three casinos in the City of Detroit or to Indian tribal gaming." The problem with the proponents' argument is that it places the proverbial cart before the horse. There is no such thing as an "internet gaming license" in Michigan unless and until SB 889 and SB 890 are signed into law. And SB 889 and SB 890 facially violate Proposal 1 by purportedly authorizing internet gambling without the requisite statewide and local votes discussed above. Just because the three Detroit casinos and tribal casinos could apply for one of the eight internet gaming licenses contemplated by SB 889 *after* SB 889 becomes Michigan law does not mean that SB 889 *as proposed* complies with article 4, § 41. In fact, the opposite is true: SB 889 on its face falls squarely within the broad provisions of Proposal 1's plain text. Accordingly, SB 889 must satisfy the electoral procedures that Proposal 1 outlines for gaming laws enacted after January 1, 2004.

Some may question how the Michigan Lottery could expand to online gaming without satisfying Proposal 1's statewide and electoral requirements. The simple answer is that no one

stepped forward and challenged that expansion under Proposal 1. But even if such a challenge had been made, it is not clear that the Michigan Lottery's use of online gaming would fall within Proposal 1's scope. To trigger the electrical procedures in Proposal 1, a new state lottery game must involve "table games or player operated mechanical or electronic devices." Const 1963, art 4, § 41. Online lottery games are not "table games" or "mechanical . . . devices." And it would be strange to describe the Internet itself as an "electronic device[ ]." Accordingly, if challenged, the Michigan Lottery would have a strong, plain-language defense to its expansion of the state lottery to include online gaming.

## II. Dormant Commerce Clause

SB 889 also violates the so-called Dormant Commerce Clause of the federal Constitution. The United States Constitution vests in Congress the power to "regulate commerce . . . among the several States." US Const, art I, § 8, cl 3. While the Commerce Clause gives Congress the affirmative authority to regulate interstate and foreign commerce, this Clause has also been read as a negative limitation on the power of states to enact regulations that place a substantial burden on interstate commerce. *Wheeler v Charter Twp of Shelby*, 265 Mich App 657, 668; 697 NW2d 180 (2005). This restriction on state power is known as the "Dormant Commerce Clause." *Id.*

A state law may run afoul of the Dormant Commerce Clause in several ways. One of the simplest is when a state regulation regulates extraterritorial commerce. In such situations, the state regulation is virtually *per se* invalid. *Int'l Dairy Foods Ass'n v Boggs*, 622 F3d 628, 645 (CA 6, 2010). A statute is extraterritorial if it "directly controls commerce occurring wholly outside the boundaries of a State [and] exceeds the inherent limits of the enacting State's authority." *Healy v Beer Inst Inc*, 491 US 324, 336 (1989). The inquiry is whether the "practical effect of the regulation is to control product beyond the boundaries of the State." *Id.* (citing *Brown-Forman Distillers Corp v NY State Liquor Auth*, 476 US 573, 579 (1986)). And although the United States Supreme Court has typically applied the extraterritoriality test to price-fixing schemes, the Sixth Circuit Court of Appeals has endorsed the test in the context of Michigan's bottle-deposit law, since that law's regulatory effect reached across state borders and included criminal penalties. *Am Beverage Ass'n v Snyder*, 735 F3d 362, 373-376 (CA 6, 2013).

The proposed Lawful Internet Gaming Act also clearly regulates conduct across state borders and includes criminal penalties for a violation. And because the Act pertains to Internet conduct, those criminal penalties can be draconian. For example, assume that there is an Internet casino operating from Kentucky, and that Kentucky is part of a multi-jurisdictional agreement to which Michigan is also a party. The company solicits a Michigan resident who happens to be in Kentucky while on vacation. Under § 5(5) of the proposed Act, such a solicitation would be lawful. But further assume that the Michigan resident is participating in Internet gaming through a cell phone while traveling in a car, and continues to play the online game as the car passes the state line into Tennessee, which is not part of a multi-jurisdictional agreement to which Michigan is also a party. When the Kentucky Internet casino accepts the next wager, it has now violated the Act and is subject to criminal penalties, even though the Internet casino and the gambler are nowhere near Michigan. This is precisely the type of extraterritorial conduct that the Dormant Commerce Clause forbids states from regulating, much less punishing with criminal penalties. Accordingly, the Act is unconstitutional and would be unenforceable if enacted.

### III. Equal Protection/Substantive Due Process

There are several provisions of SB 889 that implicate the Equal Protection Clause or substantive due-process rights. First, SB 889 only authorizes eight Internet gaming licensees at any one time. 2016 SB 889, § 6(5). Second, SB 889 prohibits felons from being able to create an online gaming account. *Id.* § 11(1)(a). Because these provisions target only certain groups of people and treat similarly situated groups differently, they can be challenged under both the Equal Protection Clause and the substantive due-process clause.

#### a. *Equal Protection*

Michigan's Equal Protection Clause states: "No person shall be denied the equal protection of the laws; nor shall any person be denied the enjoyment of his civil or political rights or be discriminated against in the exercise thereof because of religion, race, color or national origin. The legislature shall implement this section by appropriate legislation." Const 1963, art 1, § 2. This Clause provides equal protection of the law to all individuals and ensures that persons in similar circumstances are treated similarly.

Under the Equal Protection Clause, unless the dissimilar treatment impinges on the exercise of a "fundamental right" or targets "protected classifications" such as those based on race, gender, or national origin, the challenged statute will survive equal-protection analysis if it is rationally related to a legitimate governmental interest. *Dowrick v Oxford Charter Twp*, 233 Mich App 62, 73; 592 NW2d 724 (1998). Internet gaming is not a fundamental right, and the individuals targeted by SB 889—potential licensees and felons—are not part of a protected class because the regulation is not based on their race, origin, or gender. Accordingly, the regulations need only be rationally related to a legitimate government interest to be upheld under the Equal Protection Clause.

With respect to the provision that limits the number of licenses to eight, it is difficult to discern the legitimate government interest in allowing only eight Michigan licenses. While Michigan courts have upheld provisions that limited the number of liquor licenses in a particular locale, see *Wong v Riverview*, 126 Mich App 589, 595; 337 NW2d 589 (1983) ("Not everyone who applies for a liquor license can necessarily receive one if the city has only a limited number to issue in the first place."); *Stafford's Rest of Bloomfield, Inc v W Bloomfield Twp Bd*, 82 Mich App 607, 617; 267 NW2d 461 (1978) ("The number of liquor licenses in an area is a legislative decision, wisely entrusted to local control by the Legislature."), arbitrarily capping the number of licenses violates the Equal Protection Clause. See *Consumers Gasoline Stations v City of Pulaski*, 292 SW2d 735, 737 (Tenn, 1956) ("Although [a] city may have the right to regulate [a] business, it does not have the right to exclude certain persons from engaging in the business while allowing others to do so."). According to the *Consumers Gasoline Stations* court, such a law is "unconstitutional in that it unquestionably denies the equal protection of the laws to the person forbidden to use his property." *Id.*

This logic applies equally to SB 889. Although the Legislature can undoubtedly *regulate* Internet gaming, it cannot arbitrarily exclude certain casinos from obtaining a license while simultaneously allowing other casinos to obtain a license. In fact, Michigan would be the very

first state to impose such a limitation on the number of licenses for Internet gaming.<sup>1</sup> Moreover, the Legislature has articulated no reason for imposing this limitation. Quite the opposite, the bill's sponsor has admitted that this number is "more or less arbitrary."<sup>2</sup> SB 889 can therefore be contrasted with a local government's decision to limit the number of liquor licenses, which is often based on reasonable factors such as the number of local citizens. But because the Legislature's decision to limit the number of gaming licenses to eight has no reason, the limit is discriminatory and violates the Equal Protection Clause. (Allowing such a small number of licenses also creates a practical problem: when regulatory regimes create a limited number of licensing opportunities and vest state officials with unbridled discretion to allocate the opportunities, it creates significant potential for illegal conduct. See, e.g., *United States v Edwards*, 442 F3d 258 (CA 5, 2006) (affirming conviction of former Louisiana Governor and his son, executive assistant, and several associates for their roles in a number of illegal activities designed to profit from awarding limited number of riverboat gambling licenses).)

With respect to the prohibition on felons obtaining an account, there is no legitimate government interest in prohibiting felons from obtaining an online gaming account. It is true that felons are often provided with only limited rights. For instance, the Michigan Constitution explicitly restricts felons from serving in certain political offices. Const 1963, art 4, § 2; *id.* art 6, § 30; *id.* art 11, § 10. And a person convicted of a felony generally cannot possess a handgun. MCL 750.224f. But these restrictions are directly related to the legitimate interest in protecting the public from harm that could result from the prohibited conduct.

There is no such interest in preventing a felon from gambling. A felon who participates in Internet gaming does not pose a threat to the community in the same way as a felon who serves in public office or owns a handgun. That is why felons are not restricted from gambling in brick-and-mortar casinos. Absent a legitimate reason, denying felons the right to participate in online gambling is arbitrary and discriminatory and denies them equal protection under the law.

**b. Substantive Due Process**

In a similar manner, the Due Process Clause of the Michigan Constitution provides: "No person shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty or property, without due process of law." Const 1963, art 1, § 17. The Due Process Clause provides dual functions—it provides *procedural* safeguards against the taking of life, liberty, or property, and it also protects *substantive* liberty and property interests from unreasonable and arbitrary government actions. See *Elec Data Sys Corp v Twp of Flint*, 253 Mich App 538, 549; 656 NW2d 215 (2002). Like the Equal Protection Clause, the test for substantive due process is whether the law is rationally related to a legitimate governmental purpose. *Id.*

The same basic arguments addressed under the Equal Protection Clause would apply to substantive due process concerns as well. See *Shavers v Attorney General*, 402 Mich 554, 612-613; 267 NW2d 72 (1978) ("The test to determine if legislation comports with substantive due

<sup>1</sup> Ruddock, *Michigan Hearing Raises the Question: Is Action On Online Gambling Coming This Year or Next?*, Online Poker Report (May 5, 2016), <<http://www.onlinepokerreport.com/20650/recap-michigan-online-gambling-legislative-hearing>> (accessed May 31, 2016).

<sup>2</sup> *Id.*



process is essentially the same as the test used for equal protection.”). Thus, a strong argument can also be made that substantive due-process rights would be violated if SB 889 is enacted as proposed and limits the number of available Internet gaming licenses to eight and prohibits felons from creating gaming accounts because these restrictions are not related to legitimate government purposes.

#### IV. Procedural Due Process

Section 11 of SB 889 also implicates procedural due process concerns. Like substantive due process, the concept of procedural due process is rooted in Article 1, § 17 of the Michigan Constitution. The touchstone of procedural due process is the requirement that an individual be given the opportunity to be heard “in a meaningful manner” before his or her life, liberty, or property is taken. *Mudge v Macomb Co*, 458 Mich 87, 101; 580 NW2d 845 (1998) (citation omitted). While many due-process claims are based on state-created rights, not rights that are afforded by the Constitution, the right to a hearing prior to the deprivation does not depend upon the nature of the right violated. *Id.*

In analyzing due-process claims, courts first determine whether any procedural protections are warranted, and then assess what types of protections are warranted. *Dow v State*, 396 Mich 192, 203; 240 NW2d 450 (1976). In determining whether any procedural protections are required, courts consider whether the nature of the interest is one that is contemplated by the “liberty or property” language in the Constitution. *Id.* To do that, courts consider what procedural protections the particular situation demands. *Id.* While the form and nature of the hearing can vary, the Due Process Clause secures an absolute right to an opportunity for a meaningful hearing “before the termination becomes effective.” *Id.* (citation omitted).

Here, § 11 addresses the creation of the responsible-gaming database. It provides that the executive director of the Division may place an individual’s name in the responsible-gaming database if one of several conditions applies, including conviction for a crime, violating the Act, or simply having an “unsavory reputation” that “would adversely affect public confidence and trust in gaming.” 2016 SB 889, § 11(1). An individual whose name is placed in the database is prohibited from creating an online-gaming account, but the individual is not provided with a hearing or any other procedural action prior to being placed on the list. Rather, the executive director of the Division is provided virtually unfettered discretion in deciding whether to place an individual on the list. *Id.* (“The executive director of the board may place an individual’s name in the responsible-gaming database if any of the following apply . . .”).

This power violates the Due Process Clause by not providing a meaningful hearing, thereby depriving a listed individual of the ability to participate in online gaming. In this sense, this situation is similar to depriving an institution of the ability to obtain a liquor license without a hearing. The Michigan Court of Appeals has determined that due-process safeguards are designed to protect a liquor licensee from arbitrary or capricious decision-making by the local legislative body. *Roseland Inn, Inc v McClain*, 118 Mich App 724, 729; 325 NW2d 551 (1982). In other words, due process requires that the licensee be given notice of what criteria would result in a local body’s initiation of nonrenewal or revocation proceedings. *Id.*

The same level of notice would be required before a person could have his or her name placed in the responsible-gaming database. But under the proposed Act, the executive director is given unbridled discretion to decide when and whether an individual is placed on the responsible gaming list and there is no opportunity for a hearing prior to this deprivation occurring. As a result, § 11 violates procedural due-process requirements.

## **V. Imposition of Licensing and Application Fees**

The licensing and application fees imposed by SB 889 arguably create constitutional problems because they provide the Division with unbridled discretion to impose these fees, which can limit an institution's ability to engage in protected First Amendment expression through advertising. The United States Supreme Court has long held that a licensing fee which prevents a person from engaging in expression under the First Amendment cannot be imposed in an arbitrary manner. *Murdock v Pennsylvania*, 319 US 105, 116 (1943). Specifically, an inquiry into the constitutionality of a fee ordinance is two-fold: (1) does the regulation in question vest the public officials in charge of enforcing or applying the ordinance with a constitutionally impermissible amount of discretion, see, e.g., *Forsyth Co v Nationalist Movement*, 505 US 123, 130-132 (1992), and (2) is the fee amount based upon the costs of administering the ordinance, maintaining public order, and relieving the other burdens on public services stemming from the matter licensed, see *Cox v New Hampshire*, 312 US 569, 576-577 (1941); *Murdock*, 319 US at 116.

SB 889 imposes a significant \$100,000 application fee and an enormous \$5 million license fee. 2016 SB 889, §§ 6(7) & (14). These fees are imposed by the Division without any restrictions and could prevent an institution from being able to express its First Amendment rights allowed under the Act. As the Supreme Court has held, a "state may not impose a charge for the enjoyment of a right granted by the Federal Constitution." *Murdock*, 319 US at 114.

There is no First Amendment right to gamble, but the proposed bill also applies to advertising, which would undeniably fall within the scope of the First Amendment. As such, the imposition of these fees is similar to the license fee imposed in *Murdock*, which the U.S. Supreme Court struck down as an impermissible restriction on the free exercise of rights protected under the First Amendment. In *Murdock*, a city imposed a license fee for persons who wished to solicit or canvass within the city limits. *Id.* at 106. The Court struck down the license fee, holding that it was not a nominal fee, it was not apportioned in accordance with petitioners' revenue, and it unreasonably restricted their ability to engage in First Amendment activity by going door-to-door and soliciting donations for their religious institution. *Id.* at 113.

Likewise, the fees imposed under SB 889 are not nominal fees, are not apportioned in accordance with the licensees' revenue, and would unreasonably restrict the licensees' ability to advertise Internet gaming if they could not afford to pay the fees. Although the bill attempts to apportion the fees by stating that a "license fee imposed by this section is an advance payment of Internet wagering taxes owed by the Internet gaming licensee under section 12," 2016 SB 889, § 6(14), this provision actually creates more problems than it solves. Indeed, depending on the revenue obtained as a result of Internet wagering, this provision could create a situation in which the \$5 million license fee is still being used to pay taxes for a licensee decades in the future. As a result, prior to the conduct occurring, it is impossible to assess whether these fees are propor-

tionately related to the revenues stemming from Internet gaming, and the Legislature offers no supporting evidence for such proportionality.

Ultimately, these fees vest an impermissible amount of discretion in the Division, are not properly related to the costs of administering the proposed law, and could restrict potential licensees from engaging in protected First Amendment activity. Accordingly, the imposition of these large fees is impermissible under the First Amendment to Michigan's Constitution.

## VI. Separation of Powers

Section 8(c) of SB 889 implicates a serious separation of powers problem under the Michigan Constitution. The Michigan Constitution divides the government "into three branches: legislative, executive and judicial" and states that "[n]o person exercising powers of one branch shall exercise powers properly belonging to another branch except as expressly provided in this constitution." Const 1963, art 3, § 2. "This separation of powers is designed to preserve the independence of the three branches of government." *In re "Sunshine Law,"* 1976 PA 267, 400 Mich 660, 662; 255 NW2d 635 (1977); see also *Wood v State Admin Bd*, 255 Mich 220, 225; 238 NW 16 (1931) ("This historical and constitutional division of the powers of government forbids the extension, otherwise than by explicit language or necessary implication, of the powers of one department to another.").

Article 6, § 5 of the Michigan Constitution reserves to the judicial branch the power to "establish, modify, amend and simplify the practice and procedure in all courts of this state." Const 1963, art 6, § 5. In accordance with separation-of-powers principles, the judicial branch's authority in matters of practice and procedure is exclusive and therefore beyond the Legislature's power. *People v Watkins*, 491 Mich 450, 472; 818 NW2d 296 (2012). This exclusive authority extends only to rules of *procedure*, as courts have no power to enact court rules that establish, abrogate, or modify the *substantive* law. *Id.*

Section 8(c) of SB 889 gives the Division the ability to conduct hearings pertaining to civil violations of the Act. In defining the scope of these hearings, § 8(c) states: "In a hearing under this subdivision *or in a court action*, a reproduced copy of a record of the division relating to an Internet gaming licensee or Internet gaming vendor . . . *must be admitted into evidence* and is prima facie proof of the information contained in the record." 2016 SB 889, § 8(c) (emphasis added). By directing a judge to admit a certain kind of evidence without regard to the Michigan Rules of Evidence, § 8(c) usurps the judiciary's role in establishing the rules of practice and procedure as provided for in Article 6, § 5.

To properly assess whether § 8(c) violates the separation-of-powers principle, a court would apply the test adopted in *McDougall v Schanz*, 461 Mich 15; 597 NW2d 148 (1999). In *McDougall*, the court created an approach to separate procedural rules—which are left to the judicial branch—from substantive rules—which are created by the legislative branch. Under the *McDougall* test, statutory rules of evidence that reflect policy considerations limited to "the orderly dispatch of judicial business," i.e., court administration, are procedural and violate Article 6, § 5. *Id.* at 31. But statutory rules of evidence that reflect policy considerations "over and beyond matters involving the orderly dispatch of judicial business" are substantive and thus do not violate the separation of powers principle. *Id.*

Here, § 8(c) is concerned primarily with court administration because it divests a court of its ability to weigh the evidence to determine whether it should be admitted. See MRE 403 (giving courts the discretion to exclude evidence where its probative value is outweighed by its prejudicial effect). Unlike in *Watkins*, where there was an overriding interest in protecting rape victims, there is no apparent overriding policy consideration present here. In other words, there is no prevailing need to protect the public from civil violations of SB 889 by requiring courts to admit evidence of a record of the division relating to a licensee or vendor. Rather, this provision merely usurps the judicial role in determining when evidence should be properly admitted. As a result, § 8(c) violates the separation-of-powers principle with respect to Article 6, § 5 of the Michigan Constitution.

## VII. Void for Vagueness Doctrine

SB 889 also implicates the void for vagueness doctrine. A statute violates this doctrine if it (1) is overbroad and impinges on First Amendment freedom; (2) does not provide fair notice of the conduct it regulates or prohibits; or (3) gives the trier of fact unstructured and unlimited discretion in determining whether the statute has been violated. *Dep't of State v Michigan Educ Ass'n-NEA*, 251 Mich App 110, 116; 650 NW2d 120 (2002). To determine whether a statute is void for vagueness, a court examines the entire statutory text and gives the statute's words their ordinary meaning. *People v Piper*, 223 Mich App 642, 646; 567 NW2d 483 (1997). A statute is unconstitutionally vague if persons of ordinary intelligence must guess at its meaning. *Id.*

For instance, in *People v Boomer*, 250 Mich App 534, 540; 655 NW2d 255 (2002), the Court of Appeals struck down as unconstitutionally vague a statute that prohibited "indecent, immoral, obscene, vulgar or insulting language in the presence or hearing of any woman or child." Because there was no restrictive language within the statute such that the statute could "possibly subject a vast percentage of the populace to a misdemeanor conviction," the court concluded that the statute did not provide fair notice of what conduct was prohibited and encouraged arbitrary and discriminatory enforcement. *Id.*

Here, § 11(1)(c) allows the Division to place an individual's name in the responsible-gaming database if "[t]he individual has performed an act or *has a notorious or unsavory reputation* such that the individual's participation in Internet gaming under this act would adversely affect public confidence and trust in gaming." 2016 SB 889 (emphasis added). The result of an individual having his or her name placed in the responsible-gaming database is that the person will be wholly prohibited from establishing an Internet gaming account or wagering on Internet games. *Id.* § 6(d).

It is unclear what is meant by a "notorious or unsavory reputation." Like the phrase that was struck down in *Boomer*, the phrase "notorious or unsavory reputation" is not defined nor is it given any context within the bill. As a result, this section does not provide fair notice of the conduct it is regulating, because a person of ordinary intelligence would have to simply guess at what a "notorious or unsavory reputation" could include. Prohibiting a person from participating in Internet gaming based on such a vague phrase not only affords too much discretion to the Division, but also unfairly strips a person of his or her rights under SB 889 without providing fair notice. Accordingly, § 11(1)(c) violates the void for vagueness doctrine under the Michigan Constitution.

## VIII. Overbreadth Doctrine

Finally, § 6(9)(b) of SB 889 implicates the overbreadth doctrine. A law may be found to be unconstitutionally overbroad where it prohibits a substantial amount of constitutionally protected conduct. *People v Vandenberg*, 307 Mich App 57, 62; 859 NW2d 229 (2014) (finding unconstitutional the phrase “exciting a contention” because it criminalized the peaceable public expression of ideas). Criminal statutes must be scrutinized with particular care, and those that prohibit a substantial amount of constitutionally protected conduct may be facially overbroad even if they have a legitimate application. *Id.*

Section 6(9)(b) criminalizes the knowing advertisement “in this state [of] any game, product, or feature that is not authorized by the person’s license.” 2016 SB 889, § 6(9)(b). On its face, this provision is overbroad because it prohibits advertisements for *any* games or products within this State—not just those associated with online gambling. Because advertising is a constitutionally protected activity, this statute draws in both constitutional advertisements of games and products within the State and advertisements associated with online gaming that are properly prohibited under this Act. As a result, this provision is facially overbroad.

## PRACTICAL CONSIDERATIONS

### I. FOIA Disclosure Requirements

In addition to potentially violating the Michigan and United States Constitutions in multiple ways, SB 889 and SB 890 are also problematic for other, more practical reasons. For instance, SB 889 exempts information gathered under the Act from disclosure under Michigan’s Freedom of Information Act (“FOIA”). The FOIA statute sets forth requirements for public access to public records. Pursuant to FOIA, each public body must provide a requesting person with a reasonable opportunity for inspection and examination of public records. MCL 15.233. A public record is defined as “a writing prepared, owned, used, in the possession of, or retained by a public body in the performance of an official function, from the time it is created.” MCL 15.232(e).

SB 889 exempts from disclosure under FOIA information that is gathered or retained under SB 889. For example, under § 6(8), “information, records, interviews, reports, statements, memoranda, or other data supplied to or used by the division in the course of its review or investigation of an application for an Internet gaming license or a renewal of an Internet gaming license” are exempted from FOIA disclosure requirements. 2016 SB 889, § 6(8). Likewise, “information, records, interviews, reports, statements, memoranda, or other data supplied to or used by the division in the course of its review or investigation of an application for certification as an Internet gaming vendor” are also exempt from FOIA under SB 889. *Id.* § (7)(6). Finally, the self-exclusion list and responsible-gaming database are exempt from FOIA as well. *Id.* § (11)(7).

There is nothing facially wrong with such exemptions; FOIA specifically allows public bodies to exempt certain records from disclosure. See MCL 15.243. But the exemptions take the Act in the exact opposite direction of the public’s increased interest in *expanding* disclosure of documents retained by government agencies, not contracting them. As a result, exempting

documents from disclosure under FOIA will likely lead to increased public skepticism and uncertainty regarding Internet gaming.

## **II. Waiving Sovereign Immunity; Impact on Existing Tribal Compact**

Another practical problem with SB 889 is that it requires tribes to waive their sovereign immunity to participate in Internet gaming under the Act. Specifically, § 6(4)(b) states: "The division shall not issue an Internet gaming license under this subdivision unless the Indian tribe, in connection with its application to conduct gaming under this act, waives its sovereign immunity with respect to conducting gaming under this act and paying fees and taxes imposed under this act." 2016 SB 889, § 6(4)(b). Although it is not constitutionally prohibited to require a tribe to waive its sovereign immunity to obtain a state regulatory benefit, it is expected that tribes will be hesitant to comply with this provision, creating issues for the bill's implementation.

Enacting SB 889 could also have a significant negative impact on the revenues the State currently receives from tribal casinos. Under IGRA, a tribe may not open a casino in a state that generally prohibits gaming (like Michigan) unless it enters into a compact with the state where the casino operates. Every tribal casino in Michigan operates has a compact with Michigan. These compacts provide that the tribe must pay 8% of its net win to the Michigan Strategic Fund or Michigan Economic Development Corporation. In exchange, the State promises the tribe certain "exclusivity," i.e., that the State will not authorize a nearby casino. When the three Detroit casinos opened, a number of tribes claimed a breach of the promised exclusivity and stopped making their revenue-sharing payments, costing the State hundreds of millions of dollars. Tribes that still pay their 8% revenue sharing would likely make the same argument if SB 889 becomes law, causing the State to lose hundreds of millions of dollars more. The Senate Fiscal Agency's Bill Analysis addresses this concern, noting that the effect could be similar to what occurred when tribes declined to pay their revenue-sharing payments due to the opening of the three Detroit casinos and the lottery's Club Keno game. Because the Senate Fiscal Agency Bill does not provide specifics, it is not clear whether the revenue generated by SB 889 online licenses would exceed monies lost as a result of tribes terminating their revenue-sharing payments to the State.

WNJ

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# Kentucky fines PokerStar's owner \$870 million to cover residents' losses

Canadian gaming company Amaya Inc has been ordered by a Kentucky court to pay \$870 million in penalties to cover alleged losses by the state's residents who played real-money poker on PokerStars' website between 2006 and 2011.

Amaya, which got PokerStars in 2014 through the \$4.9 billion takeover of Rational Group, said on Thursday said it planned to post a bond to stay the enforcement of the order and to appeal in early January.

The company said the ruling was in contrast to the same trial court's decision last month when it determined that damages should be based on the net losses of players.

Amaya argued the latest ruling calculated damages based on the players' gross losses, without accounting for their winnings, bonuses or free play.

The company said Kentucky relied on a "centuries old statute" that allowed people who incurred gaming losses to sue their opponents, rather than authorize the state to sue and collect such losses "for its own benefit".

Montreal-based Amaya said if it is obligated to pay the amount, it would seek recovery from the former owners of PokerStars.

(Reporting by Amrutha Gayathri in Bengaluru; Editing by Savio D'Souza)

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## MEMO TO MEDIA: Myths vs. Facts in Internet Gambling Debate

As Internet gambling has received attention in Congress, the **Coalition to Stop Internet Gambling** rebutted claims made at a recent hearing on Internet gambling before the House Energy and Commerce Subcommittee on Commerce, Manufacturing and Trade.

**CLAIM:** Prohibition didn't work with alcohol 100 years ago so it won't work with Internet gambling today.

**FACT:** No one is trying to prohibit gambling completely – Americans will still be able to gamble as they have for many years. Thoughtful regulation and prohibition are very different things. You can drink at a bar, but you can't get a Jack and Coke from a drive through. It is also legal to buy cigarettes, but you cannot buy them online.

**CLAIM:** There has not been a single reported incident of underage access in Nevada's online poker system.

**FACT:** Of course there hasn't been a reporting of an underage gambling incident in Nevada because law enforcement doesn't have the tools to police these activities. Law enforcement can't prevent a parent or older brother from handing his smart phone to a minor. Moreover, the FBI has warned that the technology to prevent minors from accessing Internet gambling is easily defeated. As Internet gambling spreads, young people will likely devise new and even more creative ways to do an end-run around the current technology, which we already know is insufficient.

(FBI, Letter to Congress, U.S. Department of Justice, 11/13/09)

**CLAIM:** Online gaming is here to stay because the government cannot put Internet gambling back in the bottle.

**FACT:** All we are proposing is a 'time-out' for Congress to more closely consider the issue. Internet gambling has only been legalized in 3 states and there are very few sites

that are even up and running at this point. The folks who invested in developing and operating these sites did so knowing full well that Congress had not had a chance to fully consider the issue, and that the Justice Department could change its position on the issue at any point during this or a subsequent Administration. History also tells us that we can rather easily shut down rogue sites. Again, there are also many legal products you can't buy on the Internet – cigarettes and pharmaceuticals from Canada come to mind.

**CLAIM:** –There is enormous pent up demand for online gambling. 50,000 people signed up for New Jersey's online gaming sites in the first week of operation.

**FACT:** We don't make laws based on demand for products and services if those products and services are shown to have devastating economic, social, and law enforcement consequences. The fact that casino companies believe there's a market for the product doesn't mean it's ok. The serious social and policy ramifications of Internet gambling ought to be thoughtfully considered before racing into the market.

**CLAIM:** Other countries are already using technology effectively to protect online gamers and prevent unauthorized use.

**FACT:** The fact that Internet gambling is already being regulated in Europe doesn't tell us how effectively it's being done. American law enforcement -- including the FBI -- believes it poses a threat. According to the FBI's Cyber Crimes Division, Internet gambling could be used for fraud and money laundering, and that age and geo-location technologies can be defeated.

In addition, brick and mortar casinos also don't really exist in Europe, so comparisons with the US gambling market are not all that instructive. Given the \$2.6 billion illegal online market in the US, it's also a safe bet a portion of those bets are being wagered on European sites which aren't effectively fire-walled to prevent unauthorized bets.

(FBI, Letter to Congress, *U.S. Department of Justice*, 11/13/09)

**CLAIM:** Americans spent nearly \$3 billion with illegal offshore gambling operators in 2012.

**FACT:** According to the AGA's own commissioned study, the actual figure is less – it is \$2.6 billion and it's declining. It was \$2.8 billion in 2011. Poker has fallen to only \$219 million from \$1.6 billion in 2006.

("Americans spent \$2.6 bn gambling online in 2012," *Global Post*, 9/24/13)

**CLAIM:** Europe has regulated Internet gaming for more than ten years.

**FACT:** Despite the European experience, American law enforcement believes that Internet gambling poses a threat. In a letter to Congress, the FBI stated that Internet

gambling could be used for fraud and money laundering, and that age and location verification technologies can be defeated.

(FBI, Letter to Congress, U.S. Department of Justice, 11/13/09)

**CLAIM:** The only way to address privacy or consumer protection issues is by legalizing and regulating Internet gambling.

**FACT:** Internet gambling is worlds apart from the controlled environment of a casino. It also opens the doors to criminal organizations that can use it to move money and fund their activities. Our experience over the past six years has also shown us it's far easier to shut down illegal sites than it will be to regulate them.

(FBI, Letter to Congress, U.S. Department of Justice, 11/13/09)

**CLAIM:** New Jersey is proving that Internet gaming can be regulated effectively.

**FACT:** Internet gambling in New Jersey is in its infancy – it is far too early to draw sweeping conclusions from that experience. Published newspaper reports have also indicated that geo-location glitches have arisen in that state.

*The Coalition to Stop Internet Gambling's mission is to restore the long-standing federal ban on Internet gambling. It will engage the public and policymakers on the threat posed by Internet gambling.*

**For more information or to arrange interviews with any of the Coalition to Stop Internet Gambling National Co-Chairs, please contact Dan Wilson at [dwilson@mercurylc.com](mailto:dwilson@mercurylc.com).**

**-END-**





## ADVANCING FAITH, FAMILY AND FREEDOM

June 27, 2014

Representative  
U.S. House of Representatives  
Washington, DC 20515

Dear Representative:

On behalf of the Family Research Council (FRC) and the families we represent, I urge you to support the bipartisan Restoration of America's Wire Act of 2014 (H.R. 4301) sponsored by Representative Jason Chaffetz (R-UT). This bill would restore the long standing federal ban on internet gambling and protect the vulnerable and their families from the 24-7 easy access of online gambling. It is urgent Congress act now to begin work on passing this important piece of legislation.

On December 23, 2011, the Justice Department unilaterally gutted the Wire Act, the 50 year old prohibition against the transmission of information related to bets and wagers, by reinterpreting its application to only apply to sports-related betting. They did so without input from Congress, law enforcement or the American public. Overnight, gambling interests in cash strapped states were given an avenue to pursue online gambling without fully appraising its consequences.

There is overwhelming evidence that the prevalence of compulsive gambling is three to four times higher among online gamblers than non-internet gamblers. The 24-7 ease of access, the speed of the game, the solitary nature of play and the ability to play multiple games at once, make online gambling inherently more dangerous than other forms of gambling.

In 1999, the National Gambling Impact Study Commission (NGISC) released its three year findings recommending an explicit moratorium on gambling expansion and a complete ban of internet gambling. The NGISC reported receiving "abundant testimony and evidence that compulsive gambling introduces a greatly heightened level of stress and tension into marriages and families, often culminating in divorce and other manifestations of familial disharmony," and that "respondents representing 2 million adults identified a spouse's gambling as significant factor in a prior divorce."

While online gambling initiatives are billed as a boon to state budgets, voters and policymakers should be aware that there is no proof expanding gambling positively impacts net state revenues. In fact, there's evidence to the contrary. Gambling functions like a regressive tax that disproportionately impacts the poor, diverting money away from local businesses and displacing existing sales tax revenue while fueling societal ills.

### FAMILY RESEARCH COUNCIL

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The increase in crime, financial hardship, lost work and the break-up of families have lead professor and economist at Baylor University, Earl L. Grinols to estimate the costs of gambling outweighing its benefits 3 to 1.

Online gambling vendors claim they will be able to screen out minors, ensure player's identities and validate they are physically located within proper jurisdictions. However, the FBI countered this claim in a 2009 letter to the Financial Services Committee stating, "While the [online gambling] vendors may claim that they can validate age and location, they are more than likely relying on credit card information and geolocation to gather this information. Both can be spoofed."

Again, I urge you to support the Restoration of America's Wire Act of 2014 (H.R. 4301) introduced by Representative Chaffetz (R-UT) and begin legislative work on this bill.

Sincerely,



David Christensen  
Vice President of Government Affairs

# THE TARRANCE GROUP

**TO:** INTERESTED PARTIES

**FROM:** DAVE SACKETT

**RE:** KEY FINDINGS FROM A NATIONAL SURVEY OF LIKELY VOTERS

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## METHODOLOGY

The Tarrance Group is pleased to present the findings from a national survey of likely voters. All respondents interviewed in this study were part of a fully representative sample of N=1000 registered "likely" voters throughout the country. Responses to this survey were gathered October 14-17, 2013. The confidence interval associated with a sample of this type is  $\pm 3.1\%$  in 19 of 20 cases.

- Voters are asked whether they have a positive or a negative view of seven (7) forms of existing gambling. Responses are summarized in the chart below.

<b>Gambling form</b>	<b>% Positive</b>	<b>% Negative</b>
State lottery	71%	23%
Horse racing tracks	58%	32%
Casinos with Las Vegas style gambling	56%	37%
Card rooms	35%	43%
Internet gambling	22%	67%
Internet poker	26%	62%

- As seen above, voters hold very different views about different types of gambling. While the lottery, horse racing tracks, and casinos all hold majority positive views. Voters have a majority negative view of both Internet gambling and of Internet poker.
- In fact, Internet gambling even has a majority negative view among expected supporters like those living in states with casinos (66%), and habitual gamblers (60%). This is clearly a form of gambling that is just seen differently than other forms of gambling.
- Internet poker also has a negative image with the majority of the likely electorate. It also has a majority negative image with expected supporters like those who live in states with casino gambling (61%), and habitual gamblers (55%).
- Even among those with a high level of familiarity and comfort with gambling, use of the Internet to gamble is still seen in a notably more negative light than other forms of gambling.
- In fact, a majority (58%) of voters favor the current ban on Internet gambling, including 40% of voters who "strongly" favor this ban. In contrast, just 32% of voters oppose this ban. It should be noted that more voters strongly favor this ban than overall voters oppose it.

# THE TARRANCE GROUP

- When informed about the Congressional proposal to lift the ban on Internet gambling and legalize this practice, fully 62% of voters oppose this proposal, including 48% who are strongly opposed. The intensity is with those opposed to Internet gambling as just 33% of voters favor legalizing Internet gambling.
- Repealing this ban is even opposed by majorities of demographic groups. Even those voter groups who are generally in favor of a smaller, less powerful federal government want to continue to use the power of the federal government to maintain the ban on Internet gambling.
- In a forced choice question on whether or not internet gambling is a different form of gambling, voters are ready these two statements:

*Internet gambling is no different than the other types of gambling that already exist, and that it is simply a natural extension of gambling options in this technological age,*

OR

*Internet gambling is very different from other types of gambling that already exist and that there are a number of key problems and potential abuses with online gambling that do not exist with traditional casino gambling.*

- In this debate, a majority (51%) of voters select that Internet gambling is a very different form of gambling while just 32% of voters select that Internet gambling is no different than other types of gambling.
- This view that Internet gambling is a very different form of gambling has a majority support among experienced gamblers like habitual gamblers (59%) and those who visited casinos two or more times (57%). As voters become more familiar with traditional forms of gambling, they become more convinced that Internet gambling is a very different form of gambling.

###





U.S. Department of Justice

Federal Bureau of Investigation

Washington, D. C. 20535-0001

November 13, 2009

Honorable Spencer Bachus  
Ranking Member  
Committee on Financial Services  
House of Representatives  
Washington, DC 20515

Dear Congressman Bachus::

I am writing in response to your letter to Director Robert S. Mueller, dated October 19, 2009, concerning your questions relating to Internet gambling. I will address these as you mentioned them in your initial correspondence:

- Does technology exist that could facilitate undetectable manipulation of an online poker game?

Yes, the technology exists to manipulate online poker games in that it would only take two or three players working in unison to defeat the other players who are not part of the team. Technically, the online poker vendors could detect this activity and put in place safeguards to discourage cheating, although it is unclear what the incentive would be for the vendor. It really comes down to a cost analysis for the vendor. How much money will I make or lose by detecting cheating and implementing the safeguards?

- Could technology be used to illicitly transfer or launder money in the guise of "innocent" participation in an online poker game, or the undetectable theft of money from one participant in such a game, by others acting in concert? If yes, to what degree?

Yes, online poker could be used to transfer ill gotten gains from one person to another, or several other people. Private tournaments exist on several online poker programs which would allow a subject to create a private game with his/her money mules. Once the game is created, the subject could raise the pot, to whatever maximum amount is allowed, and then fold before the hand is finished. This would allow the subject to transfer the money from his account to the mule account. This activity could repeat itself several times, virtually "washing the money." Once again, this activity could be detected by the vendors, but at what cost? Also, there are several ways to cheat at online poker, none of which are illegal. Teams of players could work in

unison, revealing to each other what cards they have in their hands. Based on the known cards, the team could use this knowledge to raise the pot. The players who are not part of the team would be at a distinct disadvantage because they do not have the knowledge of what cards are already in play. Several bots, software programs, have been created to play online poker. These bots are programed to take in all the information about a given hand and use that information to formulate the chances of the bot having the winning hand. Most online poker sites have a specific section of their user agreement that bans bots from their poker rooms. Bots have a distinct advantage over real players in that they can use the processing power of the computer to determine the chances of winning.

- Does the Federal government have the ability in terms of qualified personnel and financial resources to regulate Internet poker if it is legalized?

FBI investigative resources are focused on our highest priorities, that being Counterterrorism, Counterintelligence, and Cyber threats to critical infrastructures.

- Do you believe the claims of vendors who say they have technology solutions that would validate the age of a potential player in an online poker game, or the physical location, beyond a shadow of doubt?

While the vendors may claim that they can validate age and location, they are more than likely relying on credit card information and geolocation to gather this information. Both can be spoofed. For age verification, the possession of a credit card is usually the only validation these sites require. Credit card numbers are easily compromised and can be bought by the hundreds on several "underground" websites. Therefore, the simple act of owning a credit card number does nothing to validate someone's age. For location verification, the vendors are more than likely going to rely on geolocation. While geolocation can be accurate when used to determine the physical country of residence, it becomes exponentially less accurate when determining the city or zip code. Additionally, the use of Internet Protocol (IP) address based information for geolocation allows for the manipulation of geolocation information. By changing the IP address information, someone can make it appear that their residence is in a different location.

- Has U.S. law enforcement discussed potential vulnerabilities of online poker with foreign counterparts? If so, what views have been expressed?

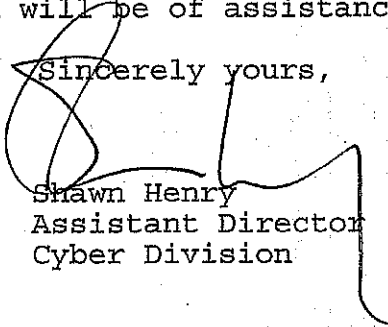
The FBI has not engaged in this discussion with our foreign partners.

- Please detail any known or alleged incidents of online cheating, particularly efforts by online casinos themselves, to manipulate the outcome of games using technology such as "pokerbots", for example.

While casino software could very easily be employed to manipulate games, the FBI has no data in this area.

I hope this information will be of assistance to you.

Sincerely yours,

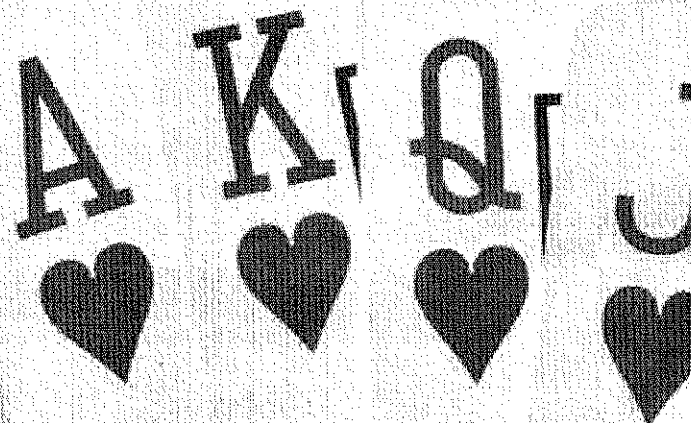


Shawn Henry  
Assistant Director  
Cyber Division



# JACKPOT! MONEY LAUNDERING THROUGH ONLINE GAMBLING

Play Online



The same basic money-laundering model used during Prohibition is applied today by the modern cyberthief.

## ABOUT McAfee LABS

McAfee Labs is the world's leading source for threat research, threat intelligence, and cybersecurity thought leadership. With data from millions of sensors across key threats vectors—file, web, message, and network—McAfee Labs delivers real-time threat intelligence, critical analysis, and expert thinking to improve protection and reduce risks.

[www.mcafee.com/us/mcafee-labs.aspx](http://www.mcafee.com/us/mcafee-labs.aspx)

## INTRODUCTION

The ingenuity of criminals never ceases to amaze us. Whether it's the things they steal or the way they steal them, creativity reigns. That cleverness also flows to converting their ill-gotten gains into "clean" money.

Modern money laundering is said to have started during Prohibition in the United States, when the proceeds from illegal alcohol sales needed to be converted into cash flowing from a legitimate business. They took advantage of common, large cash-flow businesses with anonymous, difficult-to-trace transactions—taxi services, restaurants, laundries, foreign currency exchanges come to mind—and many seemingly legitimate fortunes were built as a result. Indeed, several prominent American families trace their financial success to the sale of alcohol during Prohibition.

That same basic money-laundering model—taking advantage of accessible, high-volume businesses with anonymous, difficult-to-trace transactions—is applied today by the modern cyberthief.

In this report, we highlight one such example: the use of online gambling sites to launder dirty money. Like criminals during Prohibition, cyberthieves employing this method depend on anonymity, access, and the river of money that typically flows through an online gambling site. We hope you enjoy the read.

**Vincent Weafer, Senior Vice President, McAfee Labs**

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# CONTENTS

**JACKPOT! MONEY LAUNDERING  
THROUGH ONLINE GAMBLING**  
McAfee Labs White Paper

**This white paper was written by:**

Charles McFarland

François Paget

Raj Samani

**EXECUTIVE SUMMARY** 4

**GROWTH OF ONLINE GAMBLING** 5

Growth of licenced online gambling sites 6

Growth of unlicenced online gambling sites 8

Money laundering through online gambling sites 8

**BENEFITS OF MONEY LAUNDERING  
THROUGH ONLINE GAMBLING** 10

Anonymity 10

Access 10

Ancillary services 12

Word of caution 13

**ADDRESSING THE ISSUE** 14

**CONCLUSION** 15

**ABOUT THE AUTHORS** 15

Each of the four major online segments (sports betting, poker, casino, and bingo) will continue to grow, reaching approximately €31.2 billion (US\$43.0 billion) by 2015, implying a compound annual growth rate of approximately 7.3%.

## EXECUTIVE SUMMARY

Cybercrime stories often focus on the unfortunate victim or speculate on the vulnerability exploited in the attack, with rumors and conjecture plastered across social and other media. These two elements of an attack are often interesting, but they tell only a part of the story. The development of the attack, including researching the target, and the development of weapons and infrastructure are rarely discussed; yet they form essential elements of the crime. We looked at these components, or rather at the outsourcing of these components, in our publication *Cybercrime Exposed: Cybercrime-as-a-Service*.<sup>1</sup>

While *Cybercrime Exposed* focused on the initial stages of an attack, this report focuses on the final stage, as cybercriminals launder their proceeds to avoid detection by law enforcement agencies. Criminals use a variety of methods to conceal money, such as merchandise laundering and secret banking, but this report focuses on the most prominent method—online gambling. This method is unlikely to surprise anyone; physical gambling locations have been used for money laundering for some time. Further, the ease with which players (including criminals) can use online gambling operators makes them a considerably more attractive proposition than their physical counterparts. According to one source, “each of the four major online segments (sports betting, poker, casino, and bingo) will continue to grow, reaching approximately €31.2 billion (US\$43.0 billion) by 2015, implying a compound annual growth rate of approximately 7.3%.”<sup>2</sup>

In addition to the ease of use online gambling sites offer, players enjoy greater anonymity with cryptocurrencies as a transaction method. We discussed the use of virtual money in our recent report *Digital Laundry: An analysis of online currencies, and their use in cybercrime*.<sup>3</sup> Transacting with Bitcoin and other virtual money is gaining popularity in online casinos. If we include the number of ancillary services, such as laundering tools, to the availability and anonymity of online casinos, then their attractiveness for experienced and would-be criminals becomes very clear.

As we have stated in our recent publications, traditional crime is evolving. According to the US Federal Bureau of Investigation Bank Crime reports, bank robberies in 2011 fell to 5,014, from 5,546 in 2010.<sup>4</sup> Cybercrime is becoming the new theater for the 21st-century criminal. This report details one particular element of this evolution—money laundering through online gambling.

Getting paid—and getting away with it—remains the ultimate goal of cybercriminals.



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"Online casinos are vulnerable to a wide variety of criminal schemes. For example, criminals may participate in games with exclusively criminal players, exchanging money to launder proceeds, or a criminal might intentionally lose a game to a public official in order to effect a bribe payment."<sup>5</sup>

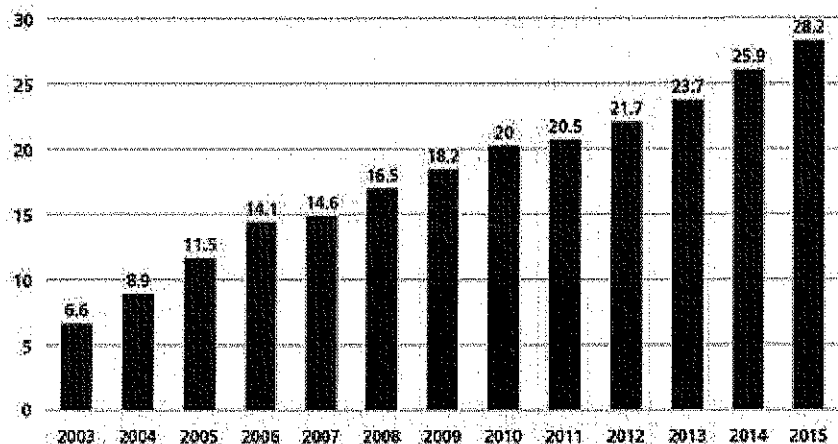
Virtual currencies, electronic banking, online gambling, and online auctions now feature heavily in money laundering techniques.

## GROWTH OF ONLINE GAMBLING

The quote at left is part of an assessment the FBI sent in September 2013 to Congressman Bill Young of Florida, in response to his letter to the FBI. This level of concern is reflected by law enforcement agencies across the world. According to the Europol Serious and Organised Crime Threat Assessment 2013, "virtual currencies, electronic banking, online gambling, and online auctions now feature heavily in money laundering techniques."<sup>6</sup>

Perhaps the rise of criminal activities within online gambling should not be a surprise, nor should their popularity. From the onset of online gambling in the mid-1990s, its growth has been nothing short of staggering, and it is forecasted to continue growing. The increase in online revenues appears to compensate for the decline in physical site-based revenues. This claim is supported by Microsoft's 2011 publication *Casino Insights and Trends*.<sup>7</sup>

GLOBAL ONLINE GAMBLING GROSS WINNINGS 2003-2015 (ESTIMATED, IN BILLIONS OF EUROS)



Source: October / H2 Gambling Capital, 2013.

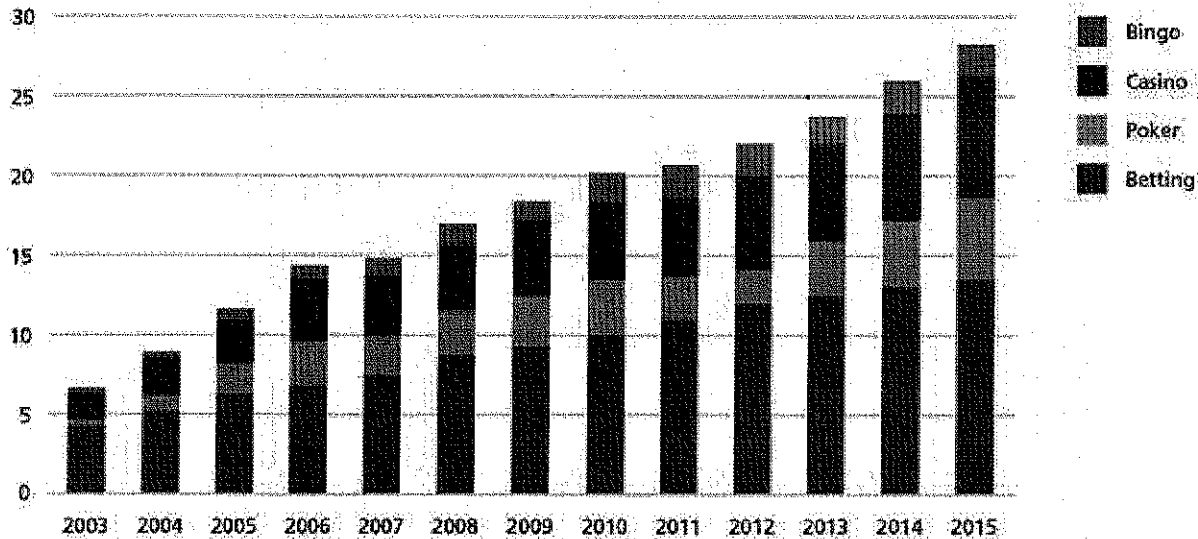
Figure 1. Gross winnings (stakes minus prizes) from online gambling, both actual and projected.

"Within the next three-year period, it is predicted that the market will grow by almost 30%, to a value of €28.24 billion (US\$38.95 billion)," says H2 Gambling Capital, a market research firm that focuses on the value and volume of activity within the global gambling industry.<sup>8</sup> This growth can be attributed to a change in consumer habits, and to the United States finally opening its doors to regulated online gambling. This rise is graphically depicted in Figures 1 and 2, taken from H2's report *There's Nothing Virtual About the Opportunity in Real-Money Gambling*.<sup>8</sup>

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# GLOBAL ONLINE GAMBLING GROSS WINNINGS BY PRODUCT 2003-2015 (ESTIMATED, IN BILLIONS OF EUROS)



Source: Oddsibo / H2 Gambling Capital, 2013.

Figure 2. Gross winnings by products.

The products in Figure 2 show the four leading categories that make up the online gambling industry. Although the majority of revenue has come from sports betting, H2 sees the greatest growth in online poker (predicted to show a compound annual growth rate of 14.4%) and casinos (10.9%), respectively. Poker and casinos offer opportunities for money laundering.

## Growth of licensed online gambling sites

When we talk about "licensed" online gambling, we refer to those gambling websites that have a jurisdictional license to conduct activities. As of November 2013 there were approximately 104 international jurisdictions that regulated a total of 2,734 Internet gambling sites (for 867 gambling-site owners) in at least one form of wagering, according to Casino City,<sup>9</sup> an independent directory and information service. Some of those jurisdictions are depicted in the following table.

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NUMBER OF REGULATED ONLINE GAMBLING WEBSITES					
Jurisdictions	March 2008	May 2009	July 2010	January 2011	November 2013
Alderney	54	66	96	98	120
Antigua and Barbuda	142	77	78	65	50
Costa Rica	244	220	226	185	181
Cyprus	22	32	45	47	120
Gibraltar	172	216	255	262	312
Isle of Man	10	15	26	38	79
Italy	1	57	59	60	230
Kahnawake (Mohawk Territory, Canada)	324	251	216	181	120
Netherlands Antilles	320	271	312	280	456
United Kingdom	107	92	99	108	103

Source: Casino City.

Table 1: Licensed gambling sites are regulated by a wide variety of countries.



Figure 3: A partial list of rogue sites according to Casino City.

In Table 1 we see that the number of licensed sites is very fluid. Consequently, the numbers presented in this report may have changed by the time you read this. For example, of the 2,734 licensed gambling sites cited, 47 are already deemed "rogue" and not trustworthy according to Casino City. (See Figure 3.) Given such volatility, it is no surprise that online players are warned to "play at their own risk."

For every licensed  
online gambling site,  
there could be up  
to nine unlicensed  
online gambling sites

## Growth of unlicensed online gambling sites

Although a large proportion of gamblers comply within local laws and use licensed gambling services (and contribute to these impressive growth figures), a significant percentage are engaged in gambling at unlicensed websites. Examples of unlicensed online gambling vary but can include bingo, poker, betting, and other casino games.

In fact, the number of licensed gambling websites is simply a drop in the ocean compared with sites that are unlicensed (and subsequently illegal in some jurisdictions). In October 2011, one count of unlicensed websites reached 25,000.<sup>10</sup> With dozens of unlicensed gambling sites being created every day, it is likely this number has increased significantly.

## Money laundering through online gambling sites

Let's turn our attention to money laundering through online gambling sites: The recent study *Online Gambling as a Game Changer to Money Laundering?* suggests three compelling reasons that explain why online gambling sites are so appealing to money launderers:<sup>11</sup>

- Gambling involves a huge volume of transactions and cash flows, which are necessary to disguise money laundering.
- Gambling does not involve a physical product (such as paper currency), making it much more complicated to track the flow of money and prove real vs. virtual turnover.
- Gambling winnings are tax free in many jurisdictions.

These advantages offer the would-be money launderer real motivation to use online gambling sites. The advantages may also include a decreased likelihood of detection as well as lower costs associated with laundering funds. Money launderers can generally use online gambling sites in two scenarios:

- When an illegal transaction occurs, the proceeds can be laundered by betting them and receiving the payouts as gambling winnings. The ability to transfer small funds into "legal gambling wins" is aided by the offshore nature of many services and vastly reduces the detection rate by law enforcement. The reduced detection rate lowers the cost of laundering as the number of potential fines decreases.
- Using gambling as a payment tool for illegal transactions, such as paying off gambling wins as cash for illegal goods. By conducting a player-to-player transfer to send funds to the account of the seller of the illegal goods, the seller is can claim the funds as tax-free gambling winnings.<sup>12</sup>

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**Key differences between licensed and unlicensed gambling sites:**

- Licensed gambling sites generally require adherence to anti-money-laundering legislation.
- Licensed gambling sites are usually audited by a supervisory authority.
- Licensed gambling sites sometimes require players to deposit funds through institutions subject to anti-money-laundering requirements.

The process associated with money movement within online gambling platforms is shown in Figure 4. We see in particular the various options regarding deposit and withdrawal methods. Although the graphical depiction is an oversimplification, the number of options available demonstrates that would-be money launderers have many opportunities to obfuscate money flows through online gambling sites, and ultimately make the task for law enforcement more difficult.

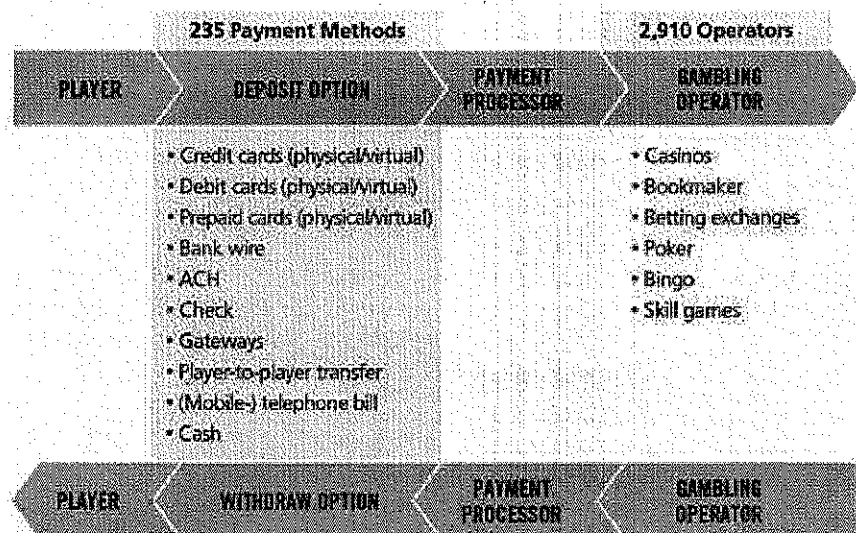
There's a key difference between licensed and unlicensed gambling sites and the likelihood of their reporting financial intelligence to law enforcement. Licensed operators require players to transmit deposits and withdrawals via licensed banks, for example. The MoneyVAL report "The use of online gambling for money laundering and the financing of terrorism purposes" makes the point:<sup>13</sup>

"Licensed online gambling operators generally fall within the scope of the national Anti-Money Laundering/Countering the Funding of Terrorism legislation and are therefore subject to Customer Due Diligence, record-keeping and reporting requirements. Supervision for AML/CFT purposes is either conducted by the Financial Intelligence Unit or else by the financial/gambling supervisory authority of the country concerned."

There is great debate regarding the level of oversight by licensed operators. Although that oversight is likely to decrease the risk of money laundering, the following risks clearly exist, according to the report:

- "Unlicensed online gambling sites do not require players to deposit funds through licensed financial institutions that are subject to adequate AML/CFT requirements."
- "Not all jurisdictions that license online gambling require online gambling operators to ensure that players deposit funds solely through licensed financial institutions that are subject to adequate AML/CFT requirements."

Further, alternate payment methods such as intermediaries, virtual currencies, and pre-paid cards for both licensed and unlicensed operators are likely to result in less scrutiny into deposits and withdrawals, and ultimately increase the risk of money laundering.



Source: McAfee Labs.

Figure 4: Steps for online gambling deposits and withdrawals.

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## BENEFITS OF MONEY LAUNDERING THROUGH ONLINE GAMBLING

There are many benefits to using online gambling platforms for money laundering. The most compelling are anonymity, access, and ancillary services.

### Anonymity

In our report *Digital Laundry* we suggested that the benefit of using virtual currencies for criminal purposes is the level of anonymity afforded to participants. This same benefit holds for those using online gambling sites.

As depicted in Figure 5, certain providers are explicit about the level of anonymity that online players enjoy.

This example not only rejects the need for personal information when using the online platform, but also cites Bitcoin as another layer to reinforce the level of anonymity afforded to players.

In spite of the claims of Bitcoin adherents, however, using online gambling platforms does not guarantee anonymity. Further resources are becoming available to offer online players even greater obfuscation to hide their true identities. In particular, some platforms leverage the TOR network for additional anonymity, as depicted in Figure 6.

TOR is free software that allows users to achieve online anonymity. By directing Internet traffic through a series of relays, users can conceal their locations and usage from surveillance, thus defeating any attempt to monitor online activities.

Online gambling sites on TOR, however, will never be as popular as those operating on the “visible” web. This is due to the technical limitations of many users, complexity, and the proliferation of scams by anonymous users.

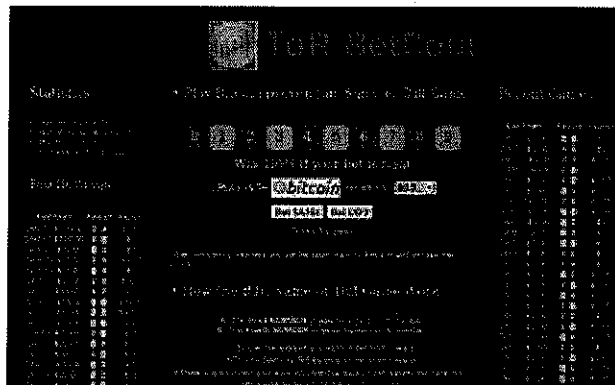


Figure 6: The TOR network offers additional anonymity to online gamblers and criminals.

### Access

TOR is an approach to achieving anonymity. But anonymity is not the only concern: Users may also have trouble with access. One access mechanism is the use of a proxy server, which can make a connection appear as if it comes from another location or country. Proxy servers could help bypass restrictions that licensed sites have in place to block players from countries where the site owner does not have a proper license.



#### Do you require my dox?

We here at SealsWithClubs flatly reject the idea that an online poker room should require your personal information. We believe the online poker experience should be similar to a live cardroom, whereby players can buy chips, play, and cash out anonymously. By using bitcoin, SealsWithClubs can securely, anonymously, and quickly process chip transactions without requiring any documentation.

Figure 5: Anonymity is a chief benefit of online gambling.

The availability of player anonymity and location-hiding services simplifies the technical obstacles money launderers face.

Another mechanism, which solves both the problems of anonymity and access, is a virtual private network (VPN), which offers the additional benefit of encrypting the traffic from the peering eyes of Internet service providers (ISPs) or law enforcement. Certain providers give users a multitude of VPN connections—for example, torguard.net advertises 300 servers across 23 countries.

A number of VPN providers offer their customers the ability to hide their IP addresses and appear to come from a particular city. Some are already advertising VPN servers located in New Jersey and many other cities in the world. Although there is no suggestion that connections are being blocked from outside the state, this particular example demonstrates that the marketplace to bypass restrictions already exists (as iPlayer users in the United States can testify). The costs will vary but could be as low as US\$20 per month. These services can be merely a single layer upon additional layers of obfuscation to mask one's identity.

The availability of such services simplifies the technical obstacles money launderers face in bypassing restrictions, or in hiding their identities. These workarounds make a mockery of geographic restrictions placed upon online gambling services. On November 26, 2013, for example, a report claimed that the state of New Jersey expanded the boundaries of its gambling to allow online players, but with the following restriction: "To take part, you will have to be within the state and at least 21 years old."<sup>14</sup>

Running A Successful + Profitable  
Gambling Ring  
By CandyMan

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**WARNING:**

Opening a gamble ring can be VERY profitable, but you will face 2 problems: 1.)The Organized Crime will not like others cutting into to this very profitable and illegal business, they may hurt you badly, or you may be among the many others who were given cement shoes and thrown in the river or lake! 2.)You face the problem of being busted for illegal gambling and lots of fines, legal costs, and jail time.

**WHAT YOU NEED TO BE**

You are going to need to be a bad ass, because you will need to collect the bets from people who lost and are not paying you. You will have to instill fear in them and bust a couple of there bones. If you have problems doing this you can always hire someone to work under you to do this dirty work. You will still have to be tough fucker to kick some ass if some of the people that work under you if they begin to steal money or try to open their own gambling ring. You also need to break apart any competition that you may have.

Figure 7: Advice for running a gambling ring.

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## Ancillary services

With the advent of many online gambling sites, we have witnessed a multitude of ancillary services that can assist would-be gamblers in obfuscating their funds from prying eyes. Some of these money-laundering tools are depicted in Figures 8 and 9.

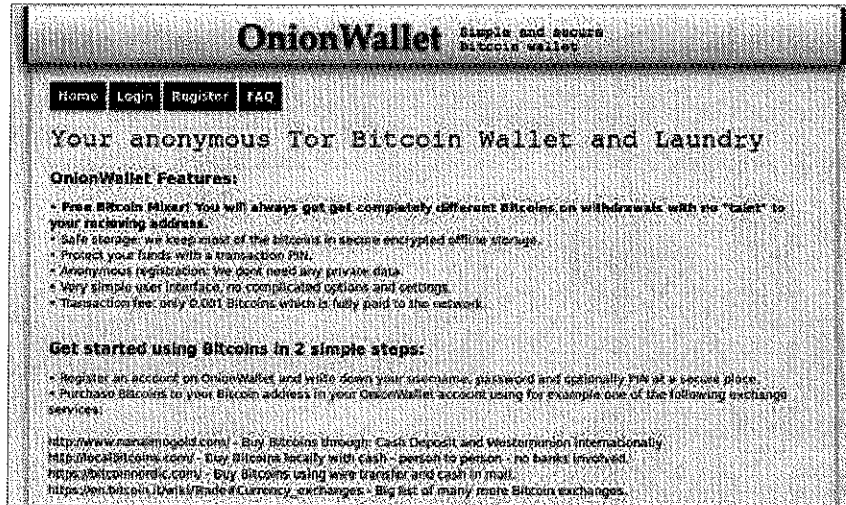


Figure 8: One site for Bitcoin use and money laundering.

The information in Figure 8 can be used to obfuscate the origins of Bitcoin transactions. These "mixers" claim to offer anonymity, as depicted in Figure 9.

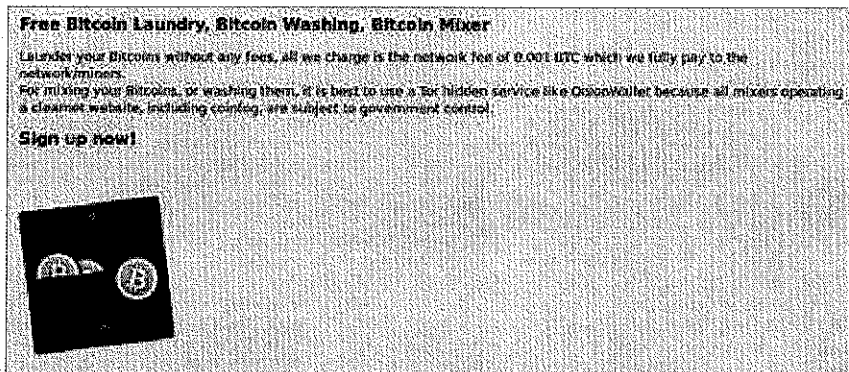


Figure 9: Another site offering Bitcoin services.



In addition to mixers, alternate services allow potential customers to anonymously acquire virtual currencies. In *Digital Laundry* we wrote about the introduction of anti-money-laundering controls within formal exchanges. The Financial Crimes Enforcement Network (FinCEN) has sent letters to Bitcoin-related businesses requiring them to comply with federal money-transmission laws.<sup>15</sup> Subsequent to the letters and other actions, a number of businesses suspended trading and others registered with FinCEN, resulting in customers receiving requests for more information to prove their identity. In May 2013, for example, a report<sup>16</sup> claimed that Mt. Gox (the now bankrupt Bitcoin exchange) would request customers looking to deposit or withdraw currencies to show government-issued identifying documents and a utility bill. Mt. Gox placed this statement on its website:

"The Bitcoin market continues to evolve, as do regulations and conditions of compliance for Mt. Gox to continue bringing secure services to our customers. It's our responsibility to provide a trusted and legal exchange, and that includes making sure that we are operating within strict anti-money laundering rules and preventing other malicious activity."

These requirements do not provide the level of anonymity that some of those purchasing virtual currencies on FinCEN-registered exchanges desire, leading to the advent of services as depicted in Figure 10.

## Word of caution

Gambling platforms, and especially unlicensed gambling sites, may seem enticing due to the level of anonymity they offer, but their propensity to not pay causes significant concern to money launderers. Clone websites are in operation, and customers may not be aware of potential scams. "The Hidden BetCoin" and "Tor BetCoin," for example, are identical with the exception of the warning presented in Figure 10.

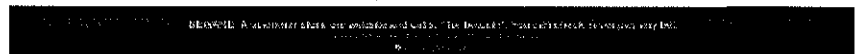


Figure 10: A warning of clone gambling websites within the TOR network.

In addition to seeing warnings, money launderers posing as gamers face challenges getting paid from some underground gambling sites. Discussions on forums show multiple users complaining of not having their winnings paid into their Bitcoin wallets, with comments such as "I bet. Was paid 1x, but I have approx – 12 wins that have not paid out."

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Greater collaboration between law enforcement agencies to target unlicensed gambling sites is required, particularly with those that operate outside the visible Internet.

## ADDRESSING THE ISSUE

Given the growing and ever-changing landscape of online gambling players and enablers, those working to apprehend cybercriminals must have a variety of skills and perspectives into this extensive money-laundering infrastructure. These actors must be able to leverage cross-sector/border and public-private partnerships, combining the capabilities of law enforcement, ISPs, Internet security companies, independent monitoring organizations, academia, and the financial institutions ultimately in receipt of suspicious fund transfers.

The work undertaken at Europol's European Cybercrime Centre is a good example of how strong global collaboration efforts with other agencies and the private sector can help address this growing threat.<sup>17</sup> These efforts include:

- **Data fusion:** The gathering and processing of information on cybercrime, and maintaining technical expertise for law enforcement in all member states.
- **Operations:** Providing member states with the technical, analytical, and forensic expertise required to conduct cybercrime investigations.
- **Local/global partnerships:** Facilitating law enforcement cooperation with partners within and outside the member community, and coordinating complex transnational cases in close collaboration with organizations such as Interpol, Eurojust (EU agency for judicial cooperation), European Union Cybercrime Taskforce, and European Cybercrime Training and Education Group.
- **Strategy:** Producing threat assessments, including trend analyses and forecasts as well as new developments on cybercriminal activity and functional processes.
- **Training and awareness:** Collaborating closely with organizations such as police academies to develop training activities and generally raise cybercrime awareness among trainees, as well as informing and building capacity among law enforcement officials, judges, and prosecutors.
- **Research and development:** Developing forensic tools to enable member states to more effectively detect and prosecute cybercriminals.

Although the legal framework can define the requirements for licensed operators, greater collaboration between law enforcement agencies to target unlicensed sites is required, particularly with those that operate outside the visible Internet (such as those that operate on TOR). Only with a strong online law enforcement capability can we prevent cybercriminals from getting paid and getting away with it. The work undertaken at the European Cybercrime Centre is a good example of how strong global collaboration efforts with other agencies and the private sector can help tackle this growing threat.

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## CONCLUSION

Online gambling sites—licensed and unlicensed—are growing in popularity. More games, more access, and more transaction methods are resulting in greater opportunities for would-be criminals to hide their illicit gains from the prying eyes of global law enforcement agencies.

Without a means to cash out, the volume of cybercrime would decrease. However, the anonymous online money-laundering marketplace today is growing rapidly with the volume of attacks. Although requiring licenses for gambling operators is an important approach, this step does nothing to halt the tide of unlicensed operators.

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